SCWP SCHINDHELM

GREEN BANKING – THE SUSTAINABLE ALTERNATIVE

In times of increased attention to global warming, sustainability, biodiversity etc., green banking as well as sustainable investment have for a long time ceased to be a niche topic. As a result of the effects of climate change and the increasing scarcity of resources, banks, small and medium-sized businesses as well as large corporations will not be able to avoid making their business model more sustainable and operating in a climate-neutral manner.

The European Union (EU) is setting its course in the direction of sustainable and renewable economic and financial systems in the area of climate protection. With the signing of the Paris Global Climate Protection Agreement and the adoption of the Agenda 2030, the EU has committed itself, among other things, to the creation of a sustainable and climate-friendly financial sector. The goal pursued by the EU entails both economic and regulatory changes.

I. OVERVIEW

The European Commission already published an “Action Plan for Financing Sustainable Growth” in 2018. The plan is in line with the 2016 Paris Climate Agreement and the United Nations Agenda 2030 for Sustainable Development and is the first comprehensive legislative proposal for the implementation of Sustainable Finance in the EU.

The action plan of the European Commission defines the following three objectives:

– Redirecting capital flows to sustainable investments;
– Managing financial risks from climate change;
– Promoting transparency and long-term financial activity.

In addition, a number of comprehensive regulations in the “Green Banking Sector” were created to implement the action plan.

II. TAXONOMY REGULATION

Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (“**Taxonomy Regulation**”), which entered into force on 12.07.2020, established the first EU-wide classification system for environmentally sustainable economic activities to be applied in the design of financial products. In this context, it must be noted that EU regulations are directly applicable in the Member States and, in contrast to EU directives, do not require any implementation in national legislation.

The Taxonomy Regulation sets out criteria for sustainable investments in order to be able to assess the degree of environmental compatibility of an investment. An investment is considered sustainable within the meaning of the Regulation if it contributes significantly to the realisation of one or more environmental goals:

– Climate protection;

– Adaptation to climate change;
– Sustainable use and protection of water and marine resources;
– Transition to a circular economy, waste prevention and recycling;
– Avoidance and reduction of environmental pollution;
– Protection of healthy ecosystems.

At the same time, a sustainable investment should not result in certain significant impairment of one or more environmental goals. The economic activity must also be conducted in compliance with the defined minimum protection requirements in the areas of working standards and human rights and must meet the technical evaluation criteria.

In the Delegated Act for the Taxonomy Regulation dated 04.06.2021 – which is directly applicable like a regulation – technical criteria have already been introduced for the first two environmental goals, based on which it is to be assessed which activities can contribute significantly to the achievement of climate protection or the adaptation to climate change. The drafting of the Delegated Acts on the remaining environmental targets is expected by the end of 2021.

A scale is provided for the applicability of the Taxonomy Regulation. Accordingly, the technical evaluation criteria with regard to the goals of climate protection and adaptation to climate change are already applicable from 01.01.2022 and only from 01.01.2023 with regard to the remaining four environmental targets.

A platform on sustainable finance has also been set up to advise on the technical assessment criteria for achieving the six environmental objectives. The platform consists of representatives of the European Environment Agency, the European supervisory authorities, the European Investment Bank and the European Investment Fund as well as experts. Under the chairmanship of the European Commission, the platform primarily performs a consultation, analysis and support function.

III. DISCLOSURE OF INFORMATION REGULATION

At the European level, a set of rules has been created with Regulation (EU) 2019/2088 on sustainability-related disclosure obligations in the financial services sector (“**Disclosure Regulation**”), in force since 29.12.2019, which requires financial market participants and financial advisors to disclose comprehensive information regarding sustainability risks. Financial market participants and financial advisors within the meaning of the Regulation include, among others:

– Investment firms and credit institutions that offer investment advice and/or portfolio management;
– Insurance companies and intermediaries that offer insurance investment products (IBIP) and/or provide insurance advice for IBIP;
– AIF and UCITS (undertaking for collective investment in transferable securities) management companies;
– AIFM (alternative investment fund manager) and UCITS management companies that offer investment advice.

Unless the individual Member States regulate otherwise, insurance brokers and securities companies that employ fewer than three employees are excluded from the application of the Disclosure Regulation.

Sustainability risks are defined as events or conditions whose occurrence could actually or potentially have a significant negative impact on the value of assets, on the asset, earnings and financial situation or reputation of a company.

The Regulation has provided clarity on how institutional investors must include environmental, social and governance factors (called ESG factors) in their investment decision.

Financial market participants and financial consultants must now disclose how and to what extent they use ESG factors and what strategies they pursue to incorporate sustainability risks in their investment decision-making process. In addition, financial market participants and financial advisors must publish whether and how they take into account the adverse effects of investment decisions on sustainability factors. In the case of financial market participants with more than 500 employees, a declaration on strategies to ensure due diligence in connection with the most important adverse effects of investment decisions on sustainability factors is required from 30.06.2021.

Disclosures on products with ecological or social features or sustainable financial products must be made both via the website and in the form of (pre-)contractual customer information obligations.

From 2023, a taxonomy report for products with an ecological sustainability aspect is also planned. Financial market participants are then required to disclose information on how and to what extent the criteria for ecologically sustainable economic activities are used if they offer financial products as ecologically sustainable investments or as investments with similar characteristics. There are three types of financial products: Financial products that promote ecological or social characteristics ("light green" products);

- Financial products that seek a sustainable investment ("dark green" products); and
- Other financial products.

The Disclosure Regulation is largely applicable with effect from 10.03.2021. The disclosure of information in the regular reports (e.g. annual financial statements) of the financial market participants is only mandatory from 21.01.2022.

IV. EBA GUIDELINES REGARDING SUSTAINABLE GRANTING OF LOANS

On 29.05.2020, the European Banking Authority (EBA) published guidelines for the granting of loans and monitoring, which are applicable to new loans from 30.06.2021. The EBA guidelines were developed based on the experience of national supervisory authorities and should address identified deficiencies in current lending practices. The guidelines explain the interaction of credit issuance, ESG factors, money laundering and terrorist financing prevention. The stipulations in the guidelines are intended to improve the creditworthiness assessment of banks that issue loans to consumers, SMEs (small to medium sized enterprises) and corporate clients.

The supervisory authorities of the EU member states are required to make all necessary efforts to comply with the EBA guidelines.

In particular, the EBA guidelines include the following regulatory areas:

- Internal governance: Internal framework conditions for credit activities and credit risk standards and processes (considerations of ESG factors, requirements for ecologically sustainable credit allocation and credit risk assessment, etc.);
- Credit decisions: Introduction of a clear and documented framework for credit decisions;
- Pricing: Framework for the pricing of loans with regard to the requirements of risk-adjusted performance indicators according to the size, type and complexity of the loan and the risk profile of the borrower;
- Securities: Guidelines on the strategies and

procedures for the correct valuation of collateral;

– Monitoring system: Specifications regarding the credit monitoring process including appropriate data infrastructure, automatic data processing, risk management, early warning indicators and watch lists.

The guidelines published by the EBA on the granting of loans and monitoring are only applicable for the granting of new loans from 30.06.2021 and for contractual adjustments to existing loans from 30.06.2022.

V. CURRENT STATUS AND OUTLOOK

The legislative measures presented at EU level represent the first of this kind with regard to the establishment of a sustainable financial system. In the future, further steps are expected in the area of sustainable finance to ensure the consideration of ESG factors in all economic sectors to a great extent and to counteract the risks associated with climate change. With regards to lending, the measures (appropriate consideration of ESG factors, disclosure and taxonomy) are also aimed at redirecting capital flows to sustainable investments and making them transparent.

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Publisher, media owner, editorial office: Saxinger, Chalupsky & Partner s.r.o. | Hviezdoslavovo námestie 25 | 81102 Bratislava | Tel.: +421 259 300 021 | bratislava@scwp.com
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